Supreme Court, U.S.
FILED
MAR 24 1986
JOSEPH F. SPANIOL, JR.
CLERK

(5) (2) (2) (2) (3)

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

DAVID I. BLOOM *
MAYER, BROWN & PLATT
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

ROBERT A. HELMAN
STEPHEN M. SHAPIRO
WENDELL H. ADAIR, JR.
MAYER, BROWN & PLATT
231 South LaSalle Street
Chicago, Illinois 60604

Attorneys for
Northern Illinois Gas Company

March 24, 1986

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

28 pp

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (the "Commission") has authority under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), to regulate and modify the rates charged by natural gas pipelines under minimum commodity bill provisions included in tariffs on file with the Commission.
2. Whether the court of appeals acted correctly in upholding the decision of the Commission to order the elimination of all variable costs from the rates charged under minimum commodity bills.
3. Whether the Commission may modify the rate provisions of tariffs on file with it on the basis of a record compiled in an informal rulemaking proceeding.

STATEMENT PURSUANT TO RULE 28.1

Northern Illinois Gas Company is a subsidiary of NICOR Inc., a publicly-held company. NICOR Inc. is not affiliated with any companies other than its wholly-owned subsidiaries.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
STATEMENT	2
REASONS FOR DENYING THE PETITIONS	9
CONCLUSION	21

TABLE OF AUTHORITIES

JUDICIAL DECISIONS: Page

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959) 12
Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968) 15
Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979) 3
F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944) 16
F.P.C. v. Louisiana Power and Light Co., 406 U.S. 621 (1972) 14
F.P.C. v. Natural Gas Pipeline Co., 315 U.S. 575 (1942) 15
F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956) 12
Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964) 15
Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985) 15
Mobil Oil Corp. v. F.P.C., 417 U.S. 283 (1974) 11
Northern Natural Gas Co. v. F.P.C., 399 F.2d 953 (D.C. Cir. 1968) 15
Otter Tail Power Co. v. United States, 410 U.S. 366 (1973) 15
Permian Basin Area Rate Cases, 390 U.S. 747 (1968) ..... *passim*
Phillips Petroleum Co. v. F.P.C., 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974) 18
SEC v. Chenery Corp., 332 U.S. 194 (1947) 18
Tenneco Oil Co. v. F.E.R.C., 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979) 18
United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 12, 14
United States v. El Paso Natural Gas Company, 376 U.S. 651 (1964) 14
United States v. Florida East Coast Ry. Co., 410 U.S. 224 (1973) 18, 20

TABLE OF AUTHORITIES—Continued

Page

United States v. Seatrain Lines, Inc., 329 U.S. 424 (1947) 12

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978) ..... *passim*

ADMINISTRATIVE DECISIONS:

Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985) 19

Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985) 19

STATUTES:

Department of Energy Organization Act

Section 403(c), 42 U.S.C. § 7173(c) (1984) 17, 20

Natural Gas Act

15 U.S.C. § 717 *et seq.* (1982) ..... *passim*

Section 4, 15 U.S.C. § 717c (1982) 2, 5, 7

Section 5, 15 U.S.C. § 717d (1982) ..... *passim*

Section 7, 15 U.S.C. § 717f (1982) 2, 12, 17

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

Nos. 85-1219, 85-1236, 85-1237, 85-1250 and 85-1252

TRANSWESTERN PIPELINE COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

---

BRIEF FOR RESPONDENT NORTHERN ILLINOIS GAS COMPANY IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the court of appeals is reported at 770 F.2d 1144 and appears at Pet. App. A-1.[1] The court of appeals' orders denying rehearing and re-

---

[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in Transwestern Pipeline Co. v. Federal Energy Regulatory Commission, No. 85-1219.

hearing *en banc*, are not officially reported and appear at Pet. App. A-57 and A-69, respectively. The orders of the Federal Energy Regulatory Commission (the "Commission") were issued in Docket No. RM83-71-000 and are identified as Order Nos. 380 (Pet. App. A-71), 380-A (Pet. App. A-129), 380-B (Pet. App. A-226), 380-C (Pet. App. A-231) and 380-D (Pet. App. A-271).

JURISDICTION

The decision of the court of appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on October 25, 1985. This Court has jurisdiction to review the decision below pursuant to 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

STATEMENT

1. Under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717-717w(1982), sales of natural gas for resale by interstate pipelines are subject to the comprehensive jurisdiction of the Commission. No such sales can take place unless the Commission has issued a certificate of public convenience and necessity under Section 7 of the NGA. 15 U.S.C. § 717f(1982). Once the service is commenced, Section 4(a) of the NGA provides that the rates and charges are "subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." 15 U.S.C. § 717c(a) (1982). Under Section 5(a) of the NGA, if the Commission finds that "any rate, charge, or classifi-

cation. . . . or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential," the Commission may fix by order the "just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed, and in force. . . ." 15 U.S.C. § 717d(a) (1982).

Generally, an interstate pipeline will have entered into a contract with each resale customer requiring the pipeline to provide, upon request on any given day, a maximum quantity of natural gas (the "daily contract quantity"). The rates for services to be charged under the contract will be contained in tariffs on file with and subject to the review of the Commission. To compensate the pipeline for the costs associated with providing gas sales service on demand, the tariff will require each customer to pay a monthly demand charge, based on the contract quantity, which recovers a portion of the fixed costs incurred by the pipeline in providing the service.[2] A customer must pay the demand charge, whether or not it actually requests or receives service during any billing period and irrespective of the level of service actually received. A customer also is required to pay a commodity charge based on the actual volume of gas purchased from the pipeline. The commodity charge is designed to recover the remaining portion of the pipeline's fixed costs and all variable costs, including purchased gas costs.

---

[2] The exact portion depends upon the rate design used by the pipeline. The portions range from 25% to 70% of a pipeline's total fixed costs. Pet. App. A-76 n.14. *See generally* Columbia Gas Transmission Corp. v. F.E.R.C., 628 F.2d 578 (D.C. Cir. 1979).

In addition, some pipeline tariffs impose an additional charge, known as a minimum commodity bill. Minimum commodity bills require a customer to pay a charge for any shortfall in purchases below a specified level, ranging from 50% to 90% of the monthly or annual contract quantity, even though the customer does not actually purchase that quantity of gas.[3] Prior to the issuance of Order No. 380, most minimum bill charges were set at the level of the pipeline's commodity charge, including purchased gas costs. Thus, a pipeline customer purchasing only at the pipeline minimum bill level could never replace a unit of those purchases with alternate, less expensive supplies because the true cost of that unit, which would include the pipeline minimum bill charge, could never be less than the pipeline commodity price. Minimum commodity bills therefore established an effective floor on purchases by a customer from its supplying pipeline and placed a substantial restraint on the forces of competition.

2. In August 1983, the Commission issued a Notice of Proposed Rulemaking in which it proposed to remove all variable costs, including the cost of purchased gas, from the rates charged under minimum commodity bills. It noted that variable costs are not incurred when a pipeline does not make sales and therefore tentatively concluded that current minimum bills might allow pipelines to recover a "windfall." It also concluded that minimum commodity

[3] The monthly quantity generally equals the daily contract quantity times the number of days in the applicable month. If a customer's entitlement to firm sales volumes is less than the daily contract quantity times the days in the applicable period, the percentage requirement of the minimum commodity bill usually is applied to that lower volume.

bills served as barriers to competition by preventing pipeline customers from purchasing less expensive sources of supply. After receiving an initial round of comments, the Commission allowed interested parties to file reply comments.

Thereafter, the Commission promulgated Order No. 380, based on its findings that minimum commodity bills recovered costs that were not actually incurred, Pet. App. A-82 to A-85, and, further, were "anticompetitive." Pet. App. A-85 to A-92. To implement these conclusions, the Commission promulgated a new section to its regulations, 18 C.F.R. § 154.111, effective August 30, 1984, which required all costs of purchased gas to be excluded from the rate charged when customers did not purchase gas at full minimum bill levels. Pet. App. A-123 to A-124.[4] All other variable costs were required to be eliminated from the minimum commodity bill when each pipeline made its next general rate filing under Section 4 of the NGA. *Ibid.* The Commission declined to adopt the suggestion of some parties that minimum commodity bills be eliminated in their entirety or be applied to a lesser percentage of contract quantity. Pet. App. A-114 to A-115. It therefore left intact the volumetric level of minimum commodity bills and the fixed cost portion of the rates charged thereunder.

---

[4] The Commission also applied this provision to "minimum take provisions," which require customers physically to receive a specified amount of gas. The court of appeals upheld the Commission's decision to apply 18 C.F.R. § 154.111 to both minimum bill and minimum take provisions, holding that "there is no difference between the two types of clauses with respect to the Commission's rationale for the rule. . ." Pet. App. A-35 n.18.

The Commission's decision to leave intact the fixed cost portion of the rate charged under minimum commodity bills has several effects. First, it provides affected pipelines with continued assurances of recovery of the fixed costs contained in their commodity charges. Pet. App. A-22, A-138, A-143. Thus, pipelines will continue to have a full and fair opportunity to recover all costs actually incurred in meeting their contractual obligations to their customers.

Second, by retaining the pre-existing floor on the contribution to fixed cost recovery by each customer (*i.e.*, the demand charge plus commodity fixed costs for volumes up to the minimum bill level), the Commission's rule protects pipeline customers against the full impact of cost-shifting if purchase levels shift in response to Order No. 380.

Third, the scope of the Commission's action limits its competitive impact. Rather than exposing pipelines to the full brunt of gas-on-gas competition, the orders leave pipelines with a partial shield against competition. Under the rule, a pipeline's sales to a customer will drop below the minimum commodity bill level in response to competition only if the rates of competitors are lower than the pipeline's rates by an amount greater than the fixed costs contained in the pipeline's commodity charge. Even if that condition is met and a pipeline actually loses sales, the pipeline will remain shielded from the full financial impact of that competition because it will continue to recover those fixed costs.

Fourth, to the extent that sales are lost and take-or-pay liability results,[5] the Commission left undis-

[5] Under certain gas purchase contracts, a purchaser must take a specified amount of gas, or pay for that amount even if not taken. Pet. App. A-20 to A-21.

turbed those provisions of its regulations which allow a pipeline to recover the carrying-costs associated with take-or-pay liability. Pet. App. A-105 n.47. It also invited pipelines to file proposals to target those costs on specific customers if such proposals could be justified. Pet. App. A-106.

3. After petitions for rehearing were denied by the Commission, several parties petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Commission's orders, pursuant to 15 U.S.C. § 717r(b) (1982). The court of appeals affirmed the Commission, holding that the Commission had the statutory authority to issue the rule, because "Sections 4 and 5 of the Natural Gas Act empower the Commission to regulate rates, charges, and practices of natural gas companies under its jurisdiction." Pet. App. A-24 to A-25. The court of appeals also concluded that "[t]he Commission has provided abundant evidence that the recovery of variable costs through minimum bill and minimum take clauses prevents customers from shopping for low-cost gas, thereby insulating pipelines from market forces that would otherwise drive gas prices down." Pet. App. A-36. The court of appeals, after review of the record, then determined that "the Commission adequately addressed the concerns of captive customers," Pet. App. A-42, that "each of the order's essential elements is supported by substantial evidence," *ibid.*, and therefore that it was not its "province 'to supplant the Commission's balance of these interests with one more nearly to [our] liking.' *Permian Basin*, 390 U.S. at 792." *Ibid.* The court of appeals also held that the Commission was authorized to promulgate the rule after informal notice

and comment rulemaking because "the decision whether to proceed by rulemaking or adjudication lies within the broad discretion of the agency," Pet. App. A-51, and "the 'substantial evidence' provision in the Natural Gas Act does not affect the *procedure* the Commission is required to follow." Pet. App. A-54 (emphasis in original).

4. Northern Illinois Gas Company ("NI-Gas"), a respondent in this case, is a local distribution company engaged in the sale and distribution of natural gas to over 1,500,000 customers in northern Illinois. Historically, NI-Gas has purchased close to 100% of its supply from interstate pipelines, three of which have minimum commodity bills in the tariffs applicable to NI-Gas. Because these minimum commodity bills had increased the cost of gas to the consumers served by NI-Gas, NI-Gas actively supported the proposed rule and defended the final rule before the court of appeals. At the time the Commission was receiving comments in the rulemaking that resulted in Order No. 380, NI-Gas estimated that its consumers would save tens of millions of dollars per year as a direct result of the additional flexibility to substitute lower priced sources of gas for higher priced gas which NI-Gas previously had been forced to purchase. Because the rule increases NI-Gas' options for buying gas and the competition among pipelines and other sources of gas, NI-Gas anticipates that the combined impact of its increased flexibility and increased industry-wide competition will result in rates charged to its consumers that are tens of millions of dollars below the level which would prevail absent Order No. 380.

REASONS FOR DENYING THE PETITIONS

The unanimous decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. The court of appeals properly applied well-established standards for review of Commission action. After careful consideration of the record below, the court of appeals determined that the Commission's findings were supported by substantial evidence and that the Commission's actions were within its substantive authority and in accord with appropriate procedural safeguards. Petitioners' challenges to the decisions of the court of appeals and the Commission boil down to dissatisfaction with the application of settled legal principles to the facts of this particular record, and do not merit review by this Court.

I.

The decision below evidences no confusion as to the appropriate standards of review. It applies longstanding principles of judicial review of agency action in a carefully reasoned opinion. Having properly articulated these standards, the decision then applies them to a voluminous record, and determines that the actions of the Commission satisfy those standards. Thus, while the rule promulgated by the Commission might have broad impact, the review afforded by the court of appeals was sufficient to dispose of all of petitioners' contentions.

This Court has defined the responsibilities of a court reviewing agency actions taken under the NGA in the following terms:

> First, it must determine whether the Commissioner's order, viewed in light of the relevant

> facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests. . . . The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly of its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.

Permian Basin Area Rate Cases, 390 U.S. 747, 791-792 (1968). As described more fully in Parts II and III of this brief, the court of appeals properly applied each of these standards in reviewing the actions of the Commission. First, the court of appeals considered whether the actions of the Commission were within its substantive authority under the NGA and properly concluded that they were. Second, the court of appeals reviewed the record and determined that each of the essential elements of Order No. 380 was fully supported by substantial evidence. Third, the court of appeals determined that Order No. 380 adequately protected investors by maintaining the fixed cost portion of minimum commodity bills and providing a fair opportunity for pipelines to recover all prudently incurred costs.

Thus, the present case involves a routine review of administrative action under well-established legal

principles. As this Court has made clear, the responsibility for assessing a record to determine whether agency findings are supported by substantial evidence "is not ours," but that of the "courts of appeals." "This Court will intervene only in what ought to be the rare instance where the standard appears to have been misapprehended or grossly misapplied." *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283, 309-310 (1974).

II.

The court of appeals concluded that the Commission had explicit statutory authority to take the actions herein challenged. Pet. App. A-25. Section 5(a) of the NGA, 15 U.S.C. § 717d(a) (1982), states that if the Commission "find[s] that any rate, charge. . . . or any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable," the Commission shall fix by order "the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed. . ." Minimum commodity bills establish the "just and reasonable rate" to be paid by a pipeline customer when it fails to achieve a contractually agreed-upon level of purchases. Pet. App. A-25 n.9. The Commission's rule did not alter those levels or a customer's obligation to compensate a pipeline for the prudently incurred costs of providing service. The orders merely concluded that a rate for shortfalls of purchases below a pipeline's minimum bill level *which recovers costs not actually incurred* is "unjust [and] unreasonable" within the meaning of Section 5 of the NGA, 15 U.S.C. § 717d(1982), and therefore prohibited that practice on a prospective basis. Such regulation of rates and charges is precisely the au-

thority granted the Commission by Section 5 of the NGA.[6]

Petitioners' efforts to portray the Commission actions as a prohibited alteration of certificates were properly rejected by the court of appeals, Pet. App. A-25 n.9,[7] and petitioners' reliance on cases such as *United States v. Seatrain Lines, Inc.*, 329 U.S. 424 (1947), is misplaced. A certificate of public convenience and necessity issued under Section 7 of the NGA confers upon the recipient the right and obligation to provide a specific service. Absent a certificate, a party is prohibited from providing the specified service. However, the determination of the just and reasonable rate level for a particular service, which must recognize the financial interests of the pipeline, is a far different matter from revoking a pipeline's right to provide that service. The orders of the Commission, which operate on a prospective basis only, leave intact the service rights and obligations of pipelines, including each customer's obligation to com-

---

[6] Petitioners' reliance on United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956), and F.P.C. v. Sierra Pacific Power Co., 350 U.S. 348 (1956), is entirely misplaced. *E.g.*, No. 85-1219 Pet. at 8-11. Those cases deal only with the burden of proof and do not question the Commission's substantive ratemaking authority under Section 5 of the NGA when adequate findings are made by the Commission.

[7] The court of appeals also properly concluded that a certificate confers no guarantee that the initial terms of an approved service will not be changed, citing Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 389 (1959). Upon appropriate showings, "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests." Permian Basin Area Rate Cases, *supra*, 390 U.S. at 783-84.

pensate the pipelines, and the orders deal solely with the rates charged for one element of service. Thus, *Seatrain*, even if read as broadly as petitioners contend, is not relevant to the present case.

III.

Petitioners, in various guises, also argue that the Commission's rule "abrogates" contracts, destroys the "mutuality" of contracts, or denies pipelines the constitutionally-mandated fair opportunity to recover their costs. *E.g.*, No. 85-1250 Pet. at 9-10; No. 85-1236 Pet. at 9; No. 85-1237 Pet. at 10. As the court of appeals properly concluded, these arguments are devoid of merit. Pet. App. A-25 n. 9.

Under Order No. 380, pipeline customers remain obligated to pay a demand charge to compensate their supplying pipelines for standing ready to provide service up to the daily contract quantity specified in the contracts. Customers remain obligated to pay commodity charges for actual purchases and fixed costs for any minimum bill deficiency volumes. Simply put, pipeline customers remain obligated to compensate pipelines for costs prudently incurred to provide the contracted-for service, preserving mutuality between the providers and recipients of gas sales services. All the Commission did, by invoking its authority under Section 5 of the NGA, was to hold that it is "unjust [and] unreasonable" for a pipeline *to charge customers for costs which it has not incurred.*

This decision by the Commission is clearly within the power granted by the NGA and its finding that the previous rate structure for minimum commodity bill charges is unjust and unreasonable fully satisfies the requirements established by the Court in the *Mobile-Sierra* doctrine. The *Mobile-Sierra* line of

cases recognizes the primary role played by contracts under the NGA. It does not, however, prohibit the Commission from exercising its powers under Section 5 of the NGA to prescribe just and reasonable rates. The ability of the Commission to modify contractually specified rates is beyond peradventure. "The basic power of the Commission is that given it by § 5(a) to set aside and modify any rate or contract which it determines after hearing, to be 'unjust, unreasonable, unduly discriminatory, or preferential'." *United Gas Pipe Line Co. v. Mobile Gas Service Corp., supra*, 350 U.S. at 341. *See also F.P.C. v. Louisiana Power and Light Co.*, 406 U.S. 621, 646-47 (1972).

The finding of the Commission that minimum bill charges which recover unincurred costs are unjust and unreasonable cannot be characterized as arbitrary or capricious. The two essential elements of the Commission's findings, that minimum bills authorize the recovery of unincurred costs and inhibit competition, are uncontroverted. Petitioners do not dispute the conclusion of the Commission that purchased gas costs are not incurred. At most, they argue that other costs, primarily take-or-pay costs which may be claimed by producers under gas purchase contracts, may be incurred if the orders remain in effect. They further argue that while minimum commodity bills admittedly restrain competition, such bills provide pipelines with both the constitutionally-protected fair opportunity to recover their prudently-incurred costs and the additional right to retain a fixed market share, irrespective of any other factors, citing *United States v. El Paso Natural Gas Company*, 376 U.S. 651, 659-660 (1964).

However, this claim misstates the law and the impact of the Commission rule. While minimum commodity bills have been justified for several reasons,[8] an absolute grant of immunity from competition is not one of those reasons. The Commission may promote competition to better serve the public interest.[9] The sole issue is whether its actions properly recognize the financial interests of pipelines and fairly compensate investors. *Permian Basin Area Rate Cases, supra,* 390 U.S. at 790-91; *F.P.C. v. Natural Gas Pipeline Co.,* 315 U.S. 575 (1942); *Lynchburg Gas Co. v. F.P.C., supra,* 336 F.2d at 949-50 (Washington, J., concurring).

The Commission's rule, as found by the court of appeals, strikes a reasonable balance between effective competition and the expectations of investors in a manner consistent with the requirements established by this Court. The final Commission rule provides each affected pipeline with a full and fair opportunity to recover its cost of service, including the costs associated with any increased take-or-pay liability. Demand charges, which recover a significant portion of pipeline fixed costs, are unaffected by the rule. The fixed costs recovered through the pipeline's commodity charge are also unaffected because the

---

[8] *See generally* Mississippi River Transmission Corp. v. F.E.R.C., 759 F.2d 945 (D.C. Cir. 1985); Atlantic Seaboard Corp. v. F.P.C., 404 F.2d 1268 (D.C. Cir. 1968); Lynchburg Gas Co. v. F.P.C., 336 F.2d 942 (D.C. Cir. 1964). Both the Commission and the court of appeals concluded that Order No. 380 satisfied the standards set forth in those cases.

[9] *See generally* Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); Atlantic Seaboard Corp. v. F.P.C., *supra,* 404 F.2d at 1272; Northern Natural Gas Co. v. F.P.C., 399 F.2d 953, 964-65 (D.C. Cir. 1968).

minimum commodity bills continue in effect, at pre-existing levels, for such fixed costs. Only variable costs, which by definition are *not* incurred when purchases are not made, are excluded from recovery through the minimum bill charge.

Petitioners argue, however, that these unincurred variable costs are a proxy for take-or-pay costs which are an inevitable result of Order No. 380. This argument overlooks the fact that if a pipeline loses sales due to the rule and therefore incurs take-or-pay liability to producers, those costs may be reflected in its rates. Such payments, if prudently incurred, are placed in the pipeline's rate base and the pipeline may recover in its rates the carrying costs associated with that rate base account. Pet.App. A-105 n. 47. Thus, the pipeline receives a full and fair opportunity to recover its costs. The consumers' interests are therefore balanced with the pipeline's financial health. *Cf.*, *Permian Basin Area Rate Cases*, *supra*, 390 U.S. at 792; *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Arguments that the Commission's rule creates a new market structure or results in confiscatory rate structures are completely without merit.

Certain petitioners also argue that the rule is arbitrary because it will foster cost-shifting among customers. *E.g.*, No. 85-1236 Pet. at 11. But the continued availability of demand charges and fixed cost minimum commodity bills limits the potential for the shifting of fixed costs among customers. The sole potential for such cost-shifting arises if and when the pipeline reflects in its rates take-or-pay costs caused by the rule. To the extent any misallocation results, the Commission has invited pipelines to

propose allocations which properly assign such costs. Pet. App. A-106.

Thus, pipelines will continue to be fairly compensated for all costs prudently incurred in providing sales service up to the maximum contract quantities embodied in the service agreements. The financial obligations of pipeline customers remain tied to the same benchmarks. The Commission's rule merely seeks to promote competition by prohibiting pipelines from recovering costs which they themselves must acknowledge are not incurred.

IV.

The Commission adopted its rule after an informal notice and comment process, allowing for the filing of reply comments as well as the statutorily authorized petitions for rehearing. The court of appeals affirmed this use of informal rulemaking proceedings as consistent with the statutes, its precedents, and the decisions of this Court.

The statutes and precedents authorize the Commission to establish rates pursuant to rulemaking procedures.[10] Section 403(c), of the Department of Energy Organization Act, 42 U.S.C. § 7173(c) (1982) ("DOE Act"), states: "Any function. . . . which relates to the establishment of rates and charges under the. . . . Natural Gas Act, may be conducted by rulemaking procedures." Moreover, this Court has clearly sanctioned agency discretion in selecting its procedures:

---

[10] Petitioners argue that, in promulgating the rule, the Commission was not exercising its ratemaking authority. No. 85-1219 Pet. at 22-25; No. 85-1252 Pet. at 10-12. We have responded to this argument on pp. 11-13, *supra*.

> Absent constitutional constraints or extremely compelling circumstances the "administrative agencies 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties'." *FCC v. Schreiber*, 381 U.S., at 290, 85 S. Ct. at 1467, quoting from *FCC v. Pottsville Broadcasting Co.*, 309 U.S., at 143, 60 S. Ct., at 441. Indeed, our cases could hardly be more explicit.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519, 543-44 (1978). An agency may choose to proceed through either adjudication or rulemaking proceedings, *SEC v. Chenery Corp.*, 332 U.S. 194, 201-03 (1947), and it must "be given every reasonable opportunity to formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin Area Rate Cases, supra*, 390 U.S. at 790. The statutory requirement of a hearing may be satisfied by written comments. *United States v. Florida East Coast Ry. Co.*, 410 U.S. 224, 241 (1973). Given the Court's decisions in *Vermont Yankee* and *Florida East Coast Ry.*, the courts of appeals in this case and others consistently have concluded that the Commission may proceed by rulemaking in carrying out its responsibilities under the NGA. *E.g.*, Pet. App. A-50 to A-56; *Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842 (10th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Tenneco Oil Co. v. F.E.R.C.*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1979).

Petitioners nonetheless argue that *Florida East Coast Ry.* and *Vermont Yankee* prohibit the use of informal rulemaking procedures in this context because "disputed facts" were raised and the Commis-

sion was "making a 'quasi-judicial' determination by which a very small number of persons are 'exceptionally affected, in each case, upon individual grounds, . . .'" No. 85-1237 Pet. at 12, *citing Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra*, 435 U.S. at 542. This argument is meritless because the present case clearly raises "policy-type rules or standards" applicable to all competitors in a regulated industry.[11] The conclusion of the Commission that minimum commodity bills permit the recovery of unincurred costs cannot be disputed, nor can the conclusion that such minimum commodity bills adversely affect competition. And the balance to be struck between competition and other values under the NGA, within constitutional and statutory limits, is plainly a matter for industry-wide application. Indeed, any attempt to resolve these industry-wide issues on a case by case basis would have had significantly greater impact on individual pipelines.

Despite petitioners' attempt to fabricate new legal standards, the law requires only that substantial evidence support the essential elements of the Commis-

---

[11] In its Order on Rehearing, the Commission specifically considered and addressed the arguments raised by the individual pipelines. Pet. App. E. This careful consideration of the individual circumstances of the pipelines satisfies any procedural rights due to them. Furthermore, while the Commission concluded that all minimum bills which recover variable costs are unjust and unreasonable, it also concluded that it would not eliminate fixed cost minimum bills on a generic basis. Pet. App. A-115. The Commission has continued to consider fixed cost minimum commodity bills on their individual merits. *E.g.*, Tennessee Gas Pipeline Co., 32 F.E.R.C. ¶ 61,311 (1985); Transwestern Pipeline Co., 32 F.E.R.C. ¶ 61,009 (1985).

sion's order. It must be stressed that, as well as ruling on the procedure followed by the Commission, the court of appeals specifically found that "each of the order's essential elements is supported by substantial evidence." Pet. App. A-42. The court of appeals found that the procedures adopted by the Commission produced an adequate record, specifically including substantial evidence to support each essential element of the Commission's decision. The capacity of procedures to produce substantial evidence, not the procedural method itself, is the relevant issue. As this Court has held, "Congress . . . . specified necessary components of the ultimate decision, but it did not specify the method by which the Commission should acquire information about these components." *United States v. Florida East Coast Ry. Co., supra,* 410 U.S. at 235.

The DOE Act specifically authorizes the use of rulemaking procedures in ratemaking matters. 42 U.S.C. § 7173(c) (1982). The court of appeals found that the essential elements of the Commission's decisions are supported by "substantial evidence", thereby satisfying the mandates of the NGA. Thus, the conclusion of the court of appeals that the "substantial evidence" standard of the NGA "does not dictate the procedure to be followed . . . . [but] has to do with a court's review of the adequacy *vel non* of the evidence relied upon to support a finding, whatever the kind of hearing," Pet. App. A-55 (citing *American Public Gas Association v. F.P.C.*, 567 F.2d 1016, 1067 (D.C. Cir. 1977)), was mandated by the decision of this Court in *Vermont Yankee*:

> [T]he adequacy of the "record" in this type of proceeding is not correlated directly to the type of procedural devices employed, but rather turns on whether the agency has followed the statutory

> mandate of the Administrative Procedure Act or other relevant statutes. . . In short, nothing in the APA, NEPA, the circumstances of this case, the nature of the issues being considered, past agency practice, or the statutory mandate under which the Commission operates permitted the court to review and overturn the rulemaking proceeding on the basis of the procedural devices employed (or not employed) by the Commission so long as the Commission employed at least the statutory *minima*, a matter about which there is no doubt in this case.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., supra, 435 U.S. at 547-48.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted,

DAVID I. BLOOM *
MAYER, BROWN & PLATT
2000 Pennsylvania Ave., N.W.
Washington, D.C. 20006
(202) 463-2000

ROBERT A. HELMAN
STEPHEN M. SHAPIRO
WENDELL H. ADAIR, JR.
MAYER, BROWN & PLATT
231 South LaSalle Street
Chicago, Illinois 60604

Attorneys for
Northern Illinois Gas Company

* Counsel of Record

March 24, 1986